

Service Date: June 17, 1988

DEPARTMENT OF PUBLIC SERVICE REGULATION
BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MONTANA

* * * * *

IN THE MATTER of the Application)	
of CLARK FORK WATER COMPANY for)	UTILITY DIVISION
Authority to Increase Rates and)	DOCKET NO. 87.11.75
Charges for Water Service in the)	ORDER NO. 5321a
Missoula, Montana Service Area.)	
_____)	

APPEARANCES

FOR THE APPLICANT:

John Alke, Attorney at Law, Hughes, Kellner, Sullivan &
Alke, P.O. Box 1166, Helena, Montana 59624.

FOR THE INTERVENORS:

Mary Wright, Staff Attorney, Montana Consumer Counsel, 34
West Sixth Avenue, Helena, Montana 59620

FOR THE COMMISSION:

Robin McHugh, Staff Attorney, 2701 Prospect Avenue, Helena,
Montana 59620.

Ronald R. Woods, Rate Analyst, 2701 Prospect Avenue,
Helena, Montana 59620.

BEFORE:

Howard Ellis, Commissioner and Hearing Examiner

BACKGROUND

1. On November 24, 1987, Clark Fork Water Company (Applicant
or CFW) filed an application with this Commission for authority to

increase water rates and charges to its Missoula, Montana customers on a permanent basis by approximately 31.1%. This constitutes a revenue increase of approximately \$49,638.

2. Concurrent with its filing for a permanent increase in rates CFW filed an application for an interim increase in rates of approximately 31.1%, equalling a revenue increase of approximately \$49,638, or 100% of the proposed permanent increase.

3. On January 12, 1988, the Commission, having considered the merits of the Applicant's interim application, issued Order No. 5321 denying the Applicant's request for interim rate relief.

4. On February 24, 1988, following issuance of proper notice, a hearing was held in the City Council Chambers, City Hall, Missoula, Montana. The purpose of the public hearing was to consider the merits of the Applicant's proposed water rate adjustments. At the close of the hearing the parties stipulated to allow the Commission to issue a final order in this Docket.

5. The year ending December 31, 1986, is the test year in this application. The Commission finds this to be a reasonable period within which to measure the Applicant's utility revenues, expenses, and returns for the purpose of determining a fair and reasonable level of rates for water service.

FINDINGS OF FACT

6. At the public hearing the Applicant presented the testimony and exhibits of:

Mark Fisher, President, Clark Fork Water Co.

Cynthia Hauck, Certified Public Accountant.

No public testimony was received during the course of the hearing.

Post-Test Year Plant Additions

7. The Applicant in direct prefiled testimony stated that it was requesting authorization from the Commission to deviate from generally accepted ratemaking principles. The Applicant's proposed deviation from general principles was a request to, include the estimated cost of yet to be constructed capital improvements to its water system in rate base. At page 5 of his prefiled direct testimony Mark Fisher provided the Commission with the following rationale for requesting inclusion of yet to be constructed plant additions in rate base.

Q. How will such improvements be financed?

A. They can only be financed if this increase is granted. Realistically, the Company's only source of capital is bank credit. Yet, the amount of credit available to the Company is determined by its cash flow. Thus, this rate filing includes in the rate base the capital expenditures needed to begin the improvement program I have outlined above. If the Commission approves the rate application, with these improvements reflected as a pro form (sic) adjustments to the test year rate base, the Company will be able to fund the improvements, through bank financing. I am advised by counsel that the inclusion of these post-test year plant additions in rate base lies within the sound discretion of the Commission, and that the Commission has looked with some disfavor on projected plant additions. However, I have also been advised that the Commission may include them under extraordinary conditions. I believe that this case presents such extraordinary conditions. The Commission is aware of the poor service history of this Company's predecessor. Service can only be improved if

the new rates authorized by the Commission provide cash flows necessary to obtain the bank credit needed to revitalize the system. It is critical that the Company cash flow be improved so that additional capital can be invested in the Company.

8. In the Commission's view the preceding quote from the Applicant's testimony clearly indicates that the Applicant has a misconception regarding the ratemaking theory related to post-test year plant additions. Where the Commission has authorized inclusion of post-test year plant additions those additions have been constructed and were used and useful in the provision of service to consumers. By statute the Commission cannot include plant values unless the plant is actually used and useful in the provision of service. See Section 69-3-109, MCA. In the instant application the Commission has no alternative but to deny CFW's proposal to include yet to be constructed plant as post-test year plant additions. Allowing the Applicant to include the proposed capital improvements in rate base would be a direct violation of the law, because the improvements have not been constructed and are not presently used and useful in the provision of service.

9. In two prior dockets, specifically Mountain Water Company, Docket No. 84.9.59 and Montana Power Company, Docket No. 83.9.67, the Commission authorized the recovery of post-test year plant

additions. In Docket No. 86.9.51, Order No. 5252b, the Commission succinctly stated its basic rationale for allowing inclusion of post-test year plant additions, when requested by the utility:

...the level of capital expenditure was significantly above normal and a Commission failure to allow recognition

of those additions in rate base would have resulted in substantial financial harm being inflicted on the utility. The plant additions recognized in those orders were not "on going" capital maintenance, they were substantial capital expenditures incurred by the utilities to insure that an adequate water and electrical supply was available to their customers.

If CFW's proposed capital improvements had in fact been post-test year plant additions, the Commission would have authorized recovery in this Order. Clearly the stated rationale from Order No. 5252b is met by the Applicant.

10. Historically the Applicant's service area has been plagued with significant service problems, which in the opinion of the Applicant would be substantially resolved with construction of the proposed improvements. The proposed plant additions represent an approximate 28% increase in the Applicant's rate base and a failure to recognize a rate base increase of that magnitude would result in financial harm being inflicted on the utility.

11. The previously quoted testimony of the Applicant indicates that financial institutions will loan money to the Applicant, but

first it must make a showing that it will have the ability to repay the debt obligation. The Commission has denied the Applicant's request to include proposed plant additions because of the statutory requirement that plant be used and useful in the provision of service to consumers. If CFW constructs the facilities outlined in this filing and places them in service, the Commission will commit to holding this Docket open and accepting a revision to the current filing. The revised filing should include the actual costs incurred for the construction of the new facilities, a copy of the loan agreement entered into between the Applicant and the lender and updated financial statements (Income Statement and Balance Sheet) closing within 30 days of the completed construction date.

The Commission will commit to allowing the Applicant to update its test year and allow full recognition of reasonable costs associated with the newly constructed facilities, deemed used and useful. The Commission is willing to make this commitment because the treatment is consistent with previous Commission decisions, the ability of the utility to attract reasonably priced capital is enhanced, and because the Commission is aware that a need exists for improved service in CFW's service area.

12. Even though the Commission has committed to allow recovery of reasonable costs associated with newly constructed plant additions, the Applicant is cautioned that the maximum revenue increase that will be authorized in this Docket, is \$49,638. The maximum revenue increase that the Commission may authorize in this Docket is limited by CFW's original application and this Commission's notice of public hearing. Both of these documents provided for an annual revenue increase in the amount of \$49,638.

If the ultimate revenue requirement recognized by the Commission in this Docket indicates an increase in revenue in excess of that requested in the original application, the Applicant may file another rate increase application requesting full recognition of the revenue requirement.

13. The submission of a revision to the current filing in a manner consistent with the terms outlined in this Order is discretionary on the part of the Applicant. If the Applicant wishes to submit a revision it should notify the Commission within 14 days of the service day of this Order. If the Commission does not receive notification within the specified time that the Applicant wishes to continue this Docket, this Order shall be considered final and an order closing the Docket will be issued.

RATE BASE

13. In its application CFW proposed an average original cost depreciated rate base of \$380,631. The Applicant's plant accounts, which represent a significant portion of the rate base, include the estimated cost of proposed capital improvements to the water system, totalling \$94,580. The proposed rate base is averaged for the test period, therefore, the Applicant is requesting that the Commission authorize a return on \$47,290 in plant additions that are not as yet in service. The Applicant's proposed rate base was a contested issue in this proceeding.

14. The MCC asserted that the Applicant's request to include these estimated costs in rate base should be denied. The Commission agrees with the MCC and in prior findings stated its rationale for that agreement. The Commission will not burden this Order by reiterating that discussion.

15. The Applicant's Exhibit B reflects an average balance of \$529,245 for plant in service. This amount must be reduced by \$47,290 to reflect the Commission's finding that projected capital improvements are not used and useful and, therefore not includable in rate base. The Commission finds the Applicant's average plant in service during the test year is \$481,955.

16. To properly reflect the Commission's disallowance of the projected capital improvements in rate base, an adjustment to the

"Accumulated Depreciation Account" must be made. Since the average cost of the proposed capital improvements is being eliminated from the plant accounts, the average accumulated depreciation associated with those assets must also be eliminated. Average accumulated depreciation on the proposed assets, reflected in rate base, is \$2,935. The Commission finds that the Applicant's accumulated depreciation for the test period should be reduced by \$2,935 to the level of \$144,776.

17. The Commission for purposes of this rate order finds the Applicant's average original cost depreciated rate base to be \$337,179. Calculated as follows:

Total Plant	\$481,955
Less:	
Accumulated Depreciation	\$144,776
Deferred Tax	<u>858</u>
TOTAL RATE BASE	\$336,321

CAPITAL STRUCTURE

18. The Applicant proposed the following capital structure for rate case presentation:

<u>Description</u>	<u>Amount</u>	<u>Ratio</u>
Debt	\$330,937	96.49%
Equity	<u>12,034</u>	<u>3.51%</u>
TOTAL	\$342,981	100.00%

The capital structure proposed by the Applicant was not challenged by any party and is accepted by the Commission.

19. Although the Commission has accepted the Applicant's capital structure as presented in this application, the Commission feels compelled to note that it is concerned with that structure.

The Commission is cognizant that the utility industry is capital intensive and leverage is widely used to finance large plant additions, and a debt/equity ratio in the range of 50/50 to 60/40 is not atypical in the industry. But, in the Commission's opinion a utility with a debt intensive capital structure such as that presented by the Applicant is not serving the best interests of either the equity investor or the ratepayer. There are a myriad of reasons why the Commission is concerned with the existing capital structure but since the Commission has accepted the structure for this Docket the Commission will not burden this Order with those reasons. The Applicant is cautioned, however, that the Commission does expect the Applicant to construct at a minimum \$15,000 of the proposed capital improvements with equity capital. The \$15,000 figure is used by the Commission because that is the amount of

equity capital, Mark Fisher the principal owner of CFW, indicated could be made available for construction of the proposed plant.

COST OF DEBT

20. The debt capital of the Applicant consists of a \$183,428 note payable to M. Henry, and a note payable to 1st Security Bank in the amount of \$147,519. The cost of debt or interest on the note payable to M. Henry is 7% and the cost of debt on the note payable to 1st Security is 11.25%.

21. The cost of debt presented by the Applicant was not challenged by any party participating in this proceeding and appears to be reasonable. The Commission accepts the Applicant's cost of debt as presented.

COST OF EQUITY

22. The Applicant, in its application, has requested that the Commission allow a return on equity of 13.0%. Company witnesses explained that the CFW chose this level of return on equity because it was the latest allowed return on equity for Mountain Water Company, the other private water utility operating in Missoula subject to this Commission's jurisdiction. The Commission finds the Applicant's request for an equity return of 13.0% to be reasonable.

CAPITAL STRUCTURE AND COMPOSITE COST OF TOTAL CAPITAL

<u>Description</u>	<u>Amount</u>	<u>Ratio</u>	<u>Cost</u>	<u>Weighted Cost</u>
Equity	\$ 12,034	3.51%	13.00%	0.46%
Debt	183,428	53.48%	7.00%	3.74%
Debt	<u>147,519</u>	<u>43.01%</u>	11.25%	<u>4.84%</u>
Total	\$342,981	100.00%		
Composite Cost of Total Capital				9.04%

OPERATING REVENUES

23. The test period operating revenues are not a contested issue in this case. The Applicant used the actual 1986 revenues for CFW as test year revenue. The test year revenues of \$159,476, as presented by the Applicant, are accepted by the Commission.

OPERATING EXPENSES

24. The Applicant proposed total test period operation and maintenance expenses of \$140,186. The test period operation and maintenance expenses proposed by the Applicant include proforma adjustments increasing expenses by 34,113.

25. In its rate presentation the Applicant proposed to recover costs associated with new legislation, as a current operating expense of the utility. The Montana Legislature passed Senate Bill No. 28 during its 1987 legislative session. For purposes of discussion in this Order the term SB 28 will be used.

SB 28 changed the responsibility for maintenance and repair of water service lines. Prior to October 1, 1987, effective date of

SB 28, the responsibility for repair and maintenance of the entire water service line from the main to the premises of the consumer was the consumer's obligation. On October 1, 1987, it became the responsibility of the private water service provider to maintain and repair the portion of the water service line from the company's main to the consumer's property line. The Applicant's proposal to recover these expenses as a current operating expense was a contested issue.

26. The Applicant in its prefiled direct testimony indicated that the financial obligation imposed on it by SB 28 would increase its operation and maintenance expenses by \$24,000 annually. The assumptions made by the Applicant in its development of increased costs associated with SB 28 were fully explored during cross-examination of the Applicant's witnesses. During cross-examination it was determined that the Applicant had included costs associated with the repair and maintenance of the curb cock and box in its development of its SB 28 expenses. The Commission has determined, and so notified the water utilities under its jurisdiction, that repair and maintenance of the curb cock and box are not part of the responsibility assigned to the utility by SB 28. Therefore, the costs associated with repair and maintenance of the curb cock and box should be eliminated from the Applicant's cost estimate.

27. During cross-examination Mr. Fisher testified that on average it costs approximately \$500 to replace a curb cock and box.

The prefiled testimony indicates that the Applicant will be financially responsible for repair and maintenance of 12 water service lines annually. Multiplying \$500 times 12 service line repairs reveals that the Commission should reduce the Applicant's SB 28 expense by \$6,000, reducing it to \$18,000.

28. Based on the preceding Findings of Fact, proforma operation and maintenance expenses are found to be \$134,186, recognizing total proforma adjustments increasing expenses by \$28,113.

DEPRECIATION EXPENSE

29. The Applicant proposed total test period depreciation expense of \$19,439. Since the Commission has disallowed the Applicant's proposal to include proposed capital improvements in its rate base, an adjustment must be made to the depreciation expense. This adjustment will reduce the Applicant's annual depreciation expense and reflects the Commission's decision that it is not the responsibility of the consumer to reimburse the equity investor for plant determined not to be used and useful. The Commission finds that the Applicant's depreciation expense should be reduced by \$5,870.

30. The Commission finds the total annual depreciation of the Applicant to be \$13,569.

31. Taxes other than federal income are found to be \$11,913.

32. The Applicant, in the recent past, has had no federal income tax liability. With this increase the Applicant will be generating net taxable income and will incur a federal income tax liability. The Applicant projected a federal income tax liability in the amount of \$2,806. Due to Commission adjustments previously discussed, this will decrease to \$2,099.

33. The Commission finds the following test period expense appropriate for CFW:

Operation and Maintenance	\$134,186
Depreciation	13,569
Taxes other than F.I.T	11,913
Federal Income Taxes	<u>2,099</u>
Total Operating Revenue Deductions	\$161,767

34. The Applicant is found to be sustaining an operating loss in the amount of \$2,291, calculated as follows:

Operating Revenue	\$159,476
Operating Deductions	<u>\$161,767</u>
Operating Loss	\$ (2,291)

<u>REVENUE REQUIREMENT</u>		
35.	Rate Base	336,321
	Rate of Return	<u>9.04%</u>
	Return Requirement	\$30,403
	Adjusted Balance Available	
	for Return	(2,291)
	Revenue Deficiency	\$32,694

36. In order to produce a return of 9.04% on the Applicant's average original cost depreciate rate base, the Applicant will require additional annual revenue in the amount of \$32,694 from its Missoula, Montana water utility.

RATE DESIGN

37. The Applicant has proposed a uniform percentage increase be applied to the rates of all customer classifications for purposes of generating the increased revenues authorized in this Order. Absent a cost of service study, the Commission is of the opinion that a uniform percentage increase in rates to all customer classifications is the most equitable method of implementing the revenue increase authorized herein and therefore accepts the Applicant's proposal.

CONCLUSIONS OF LAW

1. The Applicant, Clark Fork Water Company, is a public utility as defined in Section 69-3-101, MCA. The Montana Public Service Commission properly exercises jurisdiction over the Applicant's rates and service pursuant to Section 69-3-102, MCA.

2. The Commission has provided adequate public notice and an opportunity to be heard as required by Section 69-3-303, MCA, and Title 2, Chapter 4, MCA.

3. The rates and rate structure approved in this Order are just and reasonable. Sections 69-3-201, and 69-3-330, MCA.

4. The Commission has statutory authority to determine whether a public utility's property is actually used and useful for the convenience of the public. Section 69-3-109, MCA.

ORDER

NOW THEREFORE, IT IS ORDERED THAT:

1. Clark Fork Water Company shall file rate schedules which reflect an increase in annual revenues of \$32,694 for its Missoula, Montana service area. The increased revenues shall be generated by increasing rates and charges as provided herein.

2. The rates approved herein shall become effective upon Commission approval.

3. The Applicant shall within 14 days of the service date of this Order provide the Commission with notification regarding its position on continuation of this Docket. If the Commission does not receive this notification within the specified time frame the Commission will issue an order closing this Docket and make this Order final.

DONE IN OPEN SESSION at Helena, Montana this 13th day of June, 1988, by a vote of 5 to 0.

BY ORDER OF THE MONTANA PUBLIC SERVICE COMMISSION

CLYDE JARVIS, Chairman

JOHN B. DRISCOLL, Commissioner

HOWARD L. ELLIS, Commissioner

TOM MONAHAN, Commissioner

DANNY OBERG, Commissioner

ATTEST:

Ann Purcell
Acting Secretary

(SEAL)

NOTE: Any interested party may request that the Commission reconsider this decision. A motion to reconsider must be filed within ten (10) days. See 38.2.4806, ARM.